

CDIAC
Bond Buyer Pre-Conference

Pre-funding Post Retirement Medical Benefits
GASB Statement 45

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CalPERS' Response the Path Forward

- The CalPERS Board decided to assist employers with these accounting requirements in a three phased approach. The three phases are as follows:
 - **Phase 1:** Assist PEMHCA employers by providing participant data extracts upon request by a PEMHCA employer.

CalPERS' Response the Path Forward

Phase 2: Create a trust fund within CalPERS under Internal Revenue Code (IRC) Section 115 to allow employers to make contributions and accumulate assets to offset the liabilities that must be accrued under GASB 45.

CalPERS' Response the Path Forward

Phase 3: Detailed cost analysis to determine the functional and business requirements necessary for a full-service Retiree Health Benefit Pre-Funding Model.

- Cost analysis for in-house actuarial valuations
- Develop a system interaction model
- Develop a business interaction model
- Document all business and technical requirements

This will require a separate Board decision toward the end of fiscal 2006-2007.

Discussion of Phase 1

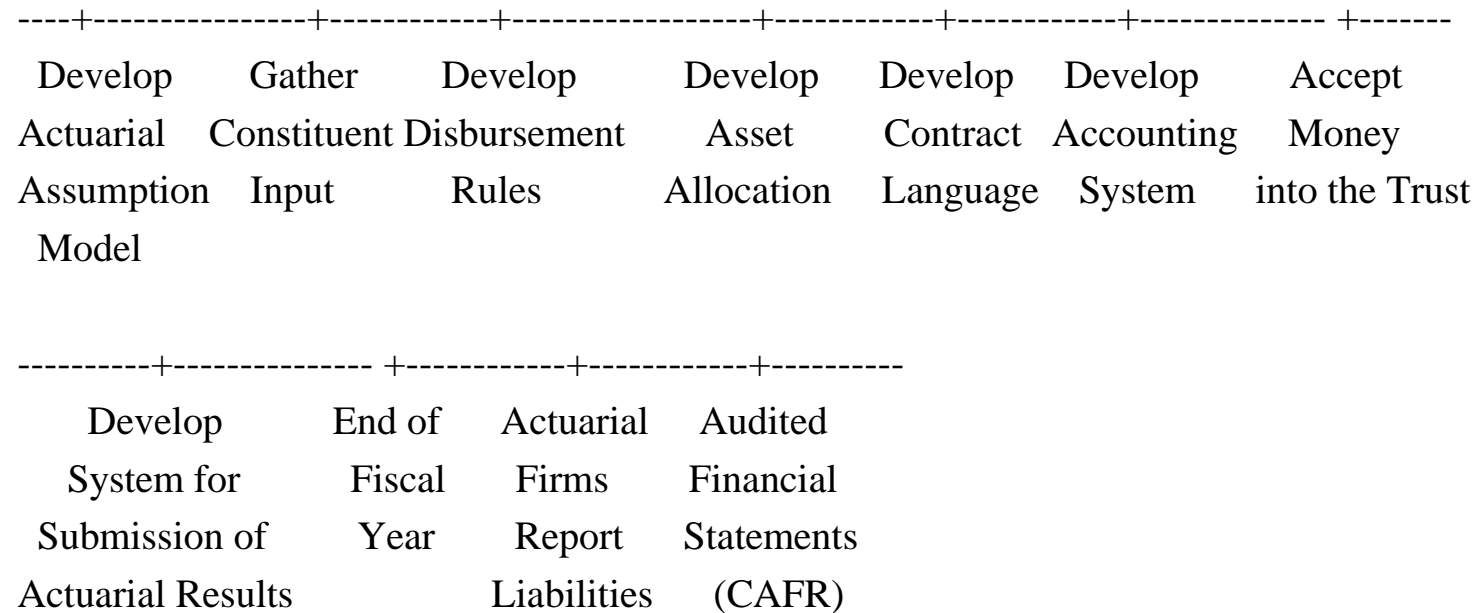
- For at least the first several years, CalPERS will not do the actuarial work on OPEB valuations.
- Employers will have to contract independently with the actuarial firm of their choice.
- A participant data extract is available from CalPERS based upon the typical data requests of actuarial firms in producing OPEB valuations.

Discussion of Phase 2

- CalPERS will create an IRC 115 trust and begin accepting contributions from employers wishing to pre-fund (at least to some extent) their OPEB liabilities.
- Scheduled to be ready around January 1, 2007.

Discussion of Phase 2

The following timeline depicts the steps necessary to begin accepting employer contributions to pre-fund post retirement benefits:



Steps within Phase 2

- **Develop an Actuarial Assumption Model**

- We believe that CalPERS will have to report the liabilities for all employers that join the new trust fund for pre-funding OPEB benefits.
- The assumption model is the result of consultation with several highly respected actuarial firms:

Gabriel, Roeder & Smith

Bartel and Associates

Milliman

EFI, Inc.

Segal

Steps within Phase 2

- **Meet with Constituents:** CalPERS staff will meet with employee and employer representatives to gather their input before developing all of the remaining steps in this process.

Steps within Phase 2

Develop Disbursement Rules:

- To avoid potential negative cash flows in the start up of this trust, staff believes that there should be a 36 month period during which an employer cannot transfer assets out of the trust or dissolve their trust agreement with CalPERS.
- Benefit disbursements will be made from the trust from its inception.
- It is unclear whether the trust should pay providers directly, reimburse employers for benefits or premiums paid, or some other structure.

Steps within Phase 2

- **Develop Disbursement Rules:**
 - Termination rules must be developed (for dissolution of the contract after the 36 month waiting period).
 - CalPERS has no desire to create any new vesting of OPEB benefits in this process.
 - A decision must be made as to whether to allow employee contributions.
 - CalPERS sponsored legislation (SB 1729) to allow participation in the 115 trust by non-PEMHCA agencies.

Steps within Phase 2

- **Develop Asset Allocation:**
 - Investment personnel and consultants want to know cash flows in order to suggest an asset allocation.
 - However, we do not know which agencies (or how many) will elect to participate. So, cash flows cannot be determined first.
 - Further, the expected rate of return of the trust (which depends on the asset allocation) will be a key factor in the employer's decision whether to pre-fund and participate in the trust.
 - For lack of a better answer, the trust will most likely start with an asset allocation (and expected return) similar to if not identical to the CalPERS Retirement Trust.

Steps within Phase 2

- **Develop Contract Language:**
 - Most of the issues raised above will need to be detailed in the contract between CalPERS and the employer joining the trust.
 - The contract must be signed by the employer prior to CalPERS accepting money from the employer into the trust.

Steps within Phase 2

- **Develop an Accounting System:**
 - A tracking system must be maintained to enable the determination of separate employer assets within the trust that has been commingled for investment purposes.
 - Disbursement rules must be known so that only valid disbursements are made from the trust.

Steps within Phase 2

- **Accept Employer Contributions into the Trust:**
 - Only employers that sign a contract with CalPERS will be allowed to contribute to the trust.
 - The contract terms will include a requirement that the actuarial firm employed by the employer use the CalPERS assumptions model.
 - The employer's contribution may not be the full ARC. It will be up to the employer to determine how much will be contributed to the trust.

Steps within Phase 2

- **Develop a System for Outside Actuarial Firms to Report their Results to CalPERS:**
 - At least for the next several years, the OPEB valuations will be done by outside actuarial firms.
 - It will be necessary that each employer have its actuarial results submitted to CalPERS.
 - It would be highly desirable that this be done in an automated fashion.

Phase 3

- Study the feasibility of developing a full-service Retiree Health Benefit Pre-Funding Model, including bringing the OPEB actuarial valuations in house.
- Several Information Technology projects would be needed to accomplish this, including a separate module added to the existing actuarial valuation system to handle OPEB benefits.
- Databases would need to be built to house extracts of participant data, plan provisions employer by employer, the actuarial assumptions by plan, the assets of each plan, etc

Phase 3

- Non-PEMHCA plans would make this very complex.
- CalPERS would need to hire or contract with health care actuaries.
- The CalPERS Pension System Resumption (PSR) project is expected to be complete on or soon after June 30, 2009.
- A complete cost benefit analysis of bringing OPEB valuation in house will be completed by June 30, 2007.

Constituent Education

Once our path forward is established additional education for both employers and employee groups will occur.